UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

MARK I. SOKOLOW, et al.,	)	
Plaintiffs,	)	
	)	
	)	No. 1:04-cv-0397 (GBD) (RLE)
v.	)	
	)	
	)	
PALESTINE LIBERATION ORGANIZATION,	)	
et al.,	)	
Defendants.	)	
	)	

AFFIDAVIT OF BRADLEY WENDT

July 13, 2015

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I. INTRODUCTION

1. I am a Senior Consultant to Charles River Associates ("CRA"), a global consulting firm that offers economic, financial, and strategic expertise to governments, law firms, accounting firms, and corporations.

2. The following is my affidavit submitted in connection with *Mark I. Sokolow, et al. v. Palestine Liberation Organization, et al*. I have been retained by Arnold & Porter LLP ("Arnold & Porter"), counsel to Plaintiffs, to provide my professional opinion regarding the following questions:

   Question 1 – Does the Palestinian Authority ("PA") have the ability to pay the Plaintiffs awarded damages of $655.5 million out of operating income?

   Question 2 – If so, what is a reasonable time horizon for the PA to pay the awarded $655.5 million out of operating income?

3. The opinions contained in this affidavit are my own and are based on the information that I have reviewed in this matter and my professional experience. Should additional information become available to me that would affect my opinions, I reserve the right to provide supplemental opinions based on that additional information. A list of the materials that I reviewed in preparing my report is contained in **Appendix 1**.

4. I have performed this work with the assistance of personnel working under my direction from CRA.

II. RELEVANT EXPERIENCE

5. Prior to joining CRA, my 25-year securities industry career included senior practitioner positions in municipal finance and municipal capital markets. My government finance and securities experience includes municipal credit analyses, municipal bond structuring and origination, security pricing, municipal bond trading, remarketing and hedging, regulatory compliance, and end-of-day portfolio pricing. My *curriculum vitae* is attached as **Appendix 2.**

6. My career in government finance started in 1984 as a member of Merrill Lynch's Municipal Securities Division. In 1990 I joined Goldman Sachs to create and run a municipal capital markets group. I became a Managing Director during my 10-year tenure as head of the Goldman Sachs Municipal Capital Markets Group.

7. While serving as an investment banker at Merrill Lynch and group head at Goldman Sachs, I authored 300 plans of finance and made 1,000 finance presentations to major governments, municipal utilities, airports, stadiums, and housing issuers. The plans of finance typically included a detailed analysis of the government or governmental project's: credit strength and ratings, revenues and expenses, operating history and projections, detailed prioritization of expenditures, lien priorities for liabilities, capital items and expenditures, funding sources, free cash flow, and bonding capacity (current and future).

8. In 2000, I became President of BondDesk Group, a bond execution platform that I co-founded and for which I raised the requisite capital. The employees and 14 investment banks owned BondDesk Group with Goldman Sachs having the largest ownership stake.

BondDesk is currently the leading execution platform for retail fixed income securities and transacts 20,000 United States government, municipal, and corporate securities per day.

9. In 2014, I joined CRA as a Senior Consultant. I provide consulting services and expert testimony on a variety of subjects, including government and municipal finance, credit analysis, capital raising, and investment banking custom and practice.

III. SUMMARY OF OPINIONS

10. In my opinion, the PA has the ability to pay Plaintiffs the awarded damages of $655.5 million from operating income over a period of not greater than 30 months.

- Months 1 through 18: $20 million per month; and
- Months 19 through final payment: $25 million per month.

11. My conclusions are based on an analysis that builds upon fiscal analyses of the PA's financial condition performed by the International Monetary Fund ("IMF"), World Bank, United Nations, and PA Ministry of Finance:

    a. According to IMF projections, the PA operating budget (excluding development grants and expenditures) is expected to be balanced by 2018 without introducing new material fiscal initiatives.[1]

[1] See Exhibit 2

b. The PA could maintain total employee compensation at 2015 levels of $2 billion per year, commencing in 2016 for three years, generating total savings of $500 million.[2]

   i. The IMF recommended that the PA develop a contingency plan that would include "a freeze on wages, allowances, and promotions," among other actions.[3]

   ii. The PA and others have acknowledged that the security, healthcare and education sectors are overstaffed and a burden on the budget.

   iii. Starting in 2012, a PA Presidential decree called for "Zero net hiring."[4]

   iv. Employee compensation has consistently outpaced inflation and been a major source of the PA's budget deficits.

   v. IMF projections indicate that the PA's overall employee compensation expense will continue to increase at a rate that outpaces inflation.

c. The West Bank, the area administered by the PA, supports Gaza, the area administered by the De Facto Government ("DFG"),[5] with payment transfers of $1 billion per year.[6]

[2] Annual savings estimated at approximately $87 million in 2016, $169 million in 2017, and $253 in 2018, totaling $509 million over the three years (see Exhibit 17).
[3] Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 10
[4] Source: April 30, 2015 Declaration of Shukry Bishara, Exhibit A-10
[5] As noted in a PA Ministry of Finance presentation, despite the fact that "[a] separationist government took hold in Gaza since June 2007," which proceeded to establish its own separate public institutions and functions, the PA "continued shouldering major expenses in the Gaza Strip." (Source: April 30, 2015 Declaration of Shukry Bishara, Exhibit A-10)

d. Rationalizing fiscal policies in Gaza would create an immediate operating surplus for the PA.

i. The PA pays an estimated $560 million per year in salaries to approximately 43,000 security and civilian employees in Gaza who do not provide services, representing over 14% of the PA's total operating expenses.[7]

ii. The PA has not collected tax revenue or electricity payments from Gaza since 2007, the resumption of which the World Bank estimates could generate $550 million per year or more.[8]

e. The IMF estimates that West Bank domestic tax revenues could be increased by $315 million per year, or more, with improved tax enforcement and collection.[9]

f. Resolving outstanding commercial issues with Israel that were identified by the PA Ministry of Finance would provide a financial contribution of $230 million per year.

[6]April 30, 2015 Declaration of Shukry Bishara, Exhibit A-11 (Ministry of Finance, "Fiscal Reforms, Entrenched Challenges and Future Objectives," Fiscal Sector Working Group, April 8, 2015), p. 26

[7] Based on total operating expenses in 2014 of $3.8 billion (See Exhibits 4, 15, and 20)

[8] Made up of $350-$400 of potential domestic taxes and import duties and $200 million in collections for electricity payments currently covered by the PA (Sources: World Bank, Supplemental Financing Document For A Proposed Gaza Emergency Response Supplemental Financing in the Amount of US$41 Million to the Palestine Liberation Organization, p. 10; World Bank, Economic Monitoring Report to the Ad Hoc Liaisons Committee, May 27, 2015, p. 9)

[9] The IMF suggested that domestic tax revenue could potentially be increased from 4.6% of GDP to 7% of GDP (an increase of 2.4% of GDP), noting that tax avoidance is widespread with taxes only paid by about 30 percent of the potential tax base. In 2015, the GDP of the West Bank and Gaza was reported to be approximately $13.1 billion (2.4% × $13.1 billion = $315 million). Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 36

12. The fiscal initiatives identified by these entities are estimated to generate over $1.2 billion per year in additional operating income upon implementation. This increase in operating income, even if only partially implemented, can satisfy the awarded damages of $655.5 million in 30 months or less, starting in January of 2016. These initiatives and efficiencies were identified by the IMF, World Bank, United Nations, and PA Ministry of Finance, apart from this dispute, to strengthen the PA's economic foundation. The PA, of course, will determine the initiatives (and the degree of implementation) which will create the greatest marginal operating income with the least disruption. If the Court orders the PA to begin payment before full implementation of these selected fiscal initiatives, additional funds could be immediately generated to comply with the Court's order, as demonstrated by the emergency cash rationing budget implemented by the PA in January 2015. I discuss my findings and analysis in greater detail below.[10]

[10] My opinion only addresses the Palestinian Authority's "*ability to pay*" and does not address the Palestinian Authority's *"willingness to pay"*.

IV. ANALYSIS OF PALESTINIAN AUTHORITY ABILTY TO PAY

A. Determinants of Financial Capacity

13. The financial capacity of a governmental organization is determined primarily by reviewing three factors:

    (i) Recurring revenues,

    (ii) Recurring expenses, and

    (iii) Liquidity as measured by,

    (a) Funds on hand, and

    (b) Capacity to borrow funds.

14. The PA represented that it has neither positive fund balance in its investment accounts[11] nor the ability to borrow $100 million for a time period greater than four months.[12] The PA further represented that the $756 million Palestine Investment Fund is not available to satisfy the Court's judgement.[13] I was instructed to accept these representations. Therefore, my ability-to-pay analysis is based on the PA's recurring operating revenues and expenses (and excludes development grants and expenses).

15. I have not included grants earmarked for development to satisfy the Court's judgment. Between 2015 and 2018, the IMF projects that the PA will receive approximately $2.1 billion in grants for development projects. This figure does not include additional

[11] "While the PA also maintains depository accounts at these institutions, the available balances in those depository accounts are at or near zero on a month-to-month basis." (Source: April 30, 2015 Declaration of Shukry Bishara, Minister of Finance and Planning, The Palestinian Authority, p. 18)
[12] "…the Qatari government offered to lend $100 million to the PA … However, the terms of the offered Qatari loan required repayment within four months." (Source: April 30, 2015 Declaration of Shukry Bishara, Minister of Finance and Planning, The Palestinian Authority, p. 14)
[13] Defendants' Reply in Support of Their Rule 62 Motion to Stay Execution of the Judgment and to Waive the Bond Requirement

pledged development donations. For example, in the Cairo Conference, donors pledged $3.5 billion for the development and reconstruction of Gaza (a portion of which is already included in the $2.1 billion above).[14]

16. In my opinion, development expenditures, as a general rule, should be funded through pre-identified capital and donor sources.[15] To the extent that planned development project expenditures exceed donor development grants or development funding in any one year, some lower-priority projects may be deferred, rescheduled or funded by public-private partnerships.[16,17]

17. As part of my analysis of the PA's operating revenues and expenses, I have reviewed and considered fiscal policy prescriptions made by international organizations such as the IMF, World Bank, and United Nations, as well as reforms identified by the PA Ministry of Finance. My analysis considers these policy prescriptions and their effect on the Defendants' ability to pay.

[14] The IMF notes that official donor aid (i.e., aid that goes through the fiscal budget) only represents 30 percent of total aid, with the remaining 70 percent of total donor aid going to off-budget support (International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 30)

[15] The PA's development expenses are currently scheduled to exceed its development grants. The IMF recommended that the PA's "[d]evelopment spending, including in Gaza, should be linked to the availability of donor aid" (Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, pp. 21 and 10)

[16] As noted by the IMF, "[p]ublic investment is often more negotiable than recurrent commitments, and thus frequently treated as a residual." (International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 21)

[17] I note that in 2014 the PA funded numerous projects of varying priorities. For example, in 2014 the PA funded projects such as a Hospitality Palace, Stadium, Cultural Center, Project to Support the Agenda of Mr. President, a Government Ministry Compound in Ramallah, and a Shopping Mall. See the PA Ministry of Finance December 2014 Monthly Report.

B. Palestinian Authority Operating Income

18. The Palestinian Authority's operating income is the difference between its operating revenues and operating expenses (excluding development grants and related expenditures).[18] Based on a recent set of projections prepared by the IMF, I have determined that the PA's baseline operating budget is expected to be balanced by 2018 without introducing new material fiscal initiatives.[19]

Table 1: Palestinian Authority Operating Budget[20]

Operating Balance ($mm)	2015 (Proj.)	2016 (Proj.)	2017 (Proj.)	2018 (Proj.)	CAGR (%)
Total Operating Revenue	$ 3,616	$ 3,980	$ 4,201	$ 4,404	6.8%
Total Operating Expense	$ 3,988	$ 4,146	$ 4,271	$ 4,412	3.4%
Operating Income (Deficit)	**$ (373)**	**$ (166)**	**$ (70)**	**$ (8)**	

[18] Operating Income excludes development grants and development expenses but includes donations that fund operating expenses.
[19] International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 21
[20] Operating Revenue and Operating Expenses include external budget support grants but exclude External Development Support Grants. Operating Income (Deficit) is equivalent to Gross Operating Balance less External Development Support Grants. See Exhibit 2.

C. Palestinian Authority Operating Revenue

19. The PA's operating revenue is made up of two components: net revenue (domestic taxes, clearance revenue taxes,[21] and other revenue) and donations.[22] The PA's net revenue has grown consistently at a compound average growth rate ("CAGR") of nearly 9% per year over the past five years. In addition, it has consistently received significant donations.[23] The following table summarizes PA's historical operating revenues for the period 2010 through 2014.

Table 2: Palestinian Authority Operating Revenues, 2010 through 2014[24]

Revenue Sources ($mm)	2010 (Actual)	2011 (Actual)	2012 (Actual)	2013 (Actual)	2014 (Actual)	CAGR (%)
Taxes [1]	1,613	1,790	1,825	2,057	2,369	10.1%
Other Revenue [2]	270	256	247	255	258	-1.1%
Net Revenue	1,883	2,046	2,072	2,312	2,627	8.7%
External Budget Support Grants [3]	1,146	815	774	1,255	984	-3.7%
Total Operating Revenue	**3,029**	**2,861**	**2,846**	**3,567**	**3,611**	**4.5%**
growth (%)	-	*-5.5%*	*-0.5%*	*25.3%*	*1.2%*	

[1] Includes domestic taxes, clearance taxes, and tax refunds.
[2] Includes dividends.
[3] Donor aid is divided into budget support and development support.

[21] From December 2014 through April 2015, following the Palestinian Authority's application for membership in the International Criminal Court, Israel withheld clearance revenues that it collected on behalf of the Palestinian Authority. The withheld clearance revenue was released after deducting amounts due to the Israel Electric Company, Israeli hospitals, and the Israel's national water company (Haaretz, "Israel releases withheld tax revenues to Palestinian Authority, March 27, 215)
[22] The IMF classifies donations as "external budget support grants" for reporting purposes.
[23] The average annual international donation to the Palestinian Authority for 2007 – 2014 was $1.139 billion per year. Contributions are broad-based, representing direct/indirect aid from about 25 countries. (Calculated using April 30, 2015 Declaration of Shukry Bishara, Exhibit A-23). The IMF notes that official donor aid (i.e., aid that goes through the fiscal budget) only represents 30 percent of total aid, with the remaining 70 percent of total donor aid going to off-budget support (International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 30)
[24] Based on data contained in a May 8, 2015 report published by the International Monetary Fund. External development support grants have not been included as part of Operating Revenues. (Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 22)

20. Notably, even though the PA's net revenues have consistently grown over the past five years on a dollar basis, they have declined as a share of GDP. Revenues declined from approximately 28.4% of GDP in 2005 to approximately 21.9% of GDP in 2014, as highlighted by the IMF.[25] The IMF further states that "[a] cross country comparison shows that government revenue in the [West Bank and Gaza] is lower compared to most of the countries in the [Middle East North Africa] region, and it is significantly lower than the average for the [West Bank and Gaza's] peer countries in the lower-middle-income group."[26] As will be discussed in greater detail below, the IMF has suggested that the PA could materially increase its revenue collection relative to GDP through the implementation of a series of tax and fiscal reforms.

[25] PA Monetary Authority and International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 35
[26] International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 35

21. Even without implementing the major tax and fiscal reforms suggested by the IMF, the PA is projected to achieve operating revenue growth at a compound average rate of about 7% per year over the next four years. The following table, which is based on the IMF's projections, summarizes the PA's projected operating revenues through 2018:

Table 3: PA Operating Revenue Projected for 2015 through 2018[27]

Revenue Source ($mm)	2015 (Proj.)	2016 (Proj.)	2017 (Proj.)	2018 (Proj.)	CAGR (%)
Taxes	2,496	2,695	2,899	3,083	7.3%
Other Revenue	269	285	302	321	6.1%
Net Revenue	2,765	2,980	3,201	3,404	7.2%
External Budget Support Grants	851	1,000	1,000	1,000	5.5%
Total Operating Revenue	**3,616**	**3,980**	**4,201**	**4,404**	**6.8%**
growth (%)	-	*10.1%*	*5.6%*	*4.8%*	

[27] External development support grants have not been included as part of Operating Revenues. (Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 22)

D. Palestinian Authority Operating Expenditures

22. The Palestinian Authority's operating expenses have steadily increased over the past five years at a compound average growth rate of about 6% per year. The following table summarizes historic operating expenses for the Palestinian Authority:

Table 4: Historical Palestinian Authority Operating Expenses (2010 through 2014)[28]

Expense Source ($mm)	2010 (Actual)	2011 (Actual)	2012 (Actual)	2013 (Actual)	2014 (Actual)	CAGR (%)
Compensation of Employees [1]	**1,612**	**1,783**	**1,767**	**1,919**	**1,963**	5.0%
Use of Goods and Services [2]	493	501	548	595	609	5.4%
Grants [3]	236	140	278	210	273	3.8%
Other Expenses [4]	733	901	933	969	1,050	9.4%
Total Operating Expenses	**3,074**	**3,325**	**3,525**	**3,693**	**3,895**	**6.1%**
growth (%)	-	*8.2%*	*6.0%*	*4.8%*	*5.5%*	

[1] Represents wage expenditure.
[2] Includes health referral costs.
[3] Grants to local governments for water and electricity purchases
[4] Includes social benefits and minor capital

23. The PA's operating expenses fall into four broad categories:

1) Compensation for government employees;

2) Purchase and use of goods and services by the government;

3) Grants provided to local governments for water and electricity purchases; and

4) Other expenses, which includes social benefits. This category includes transfer payments of $75 million[29] in 2014 made through the Ministry of Prisoner Affairs, covering payments made to certain prisoners in Israeli prisons.[30,31]

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[28] Net acquisition of nonfinancial assets (i.e., development expenditures) have not been included as operating expenses. (Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 22)
[29] NIS 267,584 translated at an exchange rate of 3.57 NIS/USD (Source: Palestinian Authority Ministry of Finance, December 2014 Monthly Report, Tables 9a and 9b).

24. Employee compensation represents the majority of the PA's historical operating expense, exceeding half of the PA's total operating expenses for the past five years (see Exhibit 5). Compensation of employees is projected to continue to equal about half of the PA's total operating expenses. The following table summarizes the IMF's projections for the PA's operating expenses over the next four years:

Table 5: PA Projected Operating Expenses for 2015 through 2018[32]

Expense Source ($mm)	2015 (Proj.)	2016 (Proj.)	2017 (Proj.)	2018 (Proj.)	CAGR (%) [1]
Compensation of Employees	**2,004**	**2,074**	**2,148**	**2,229**	3.6%
Use of Goods and Services	621	643	666	691	3.6%
Grants	237	222	208	194	-6.3%
Other Expenses	1,126	1,207	1,250	1,297	4.8%
Total Operating Expense	**3,988**	**4,146**	**4,271**	**4,412**	**3.4%**
growth (%)	-	*3.9%*	*3.0%*	*3.3%*	

[1] Calculated with projections in USD. Calculating CAGR with projections in NIS yields a slightly different result due to exchange rate fluctuations. For example, the CAGR of "Compensation of Employees" using NIS is 4.1%.

[30] It is my understanding that these transfers include payments made to prisoners kept in Israeli prisons for committing "offenses of participating in the struggle against the occupation." These prisoners also receive monetary payments upon release, and employment in the security services, with rank depending on length of time served. (Source: Prisoners and Released Prisoners Law Number (19) of 2004 and Decree Number (1) of 2013 concerning the amendment of the Prisoners and Released Prisoners Law Number (19) of 2004)

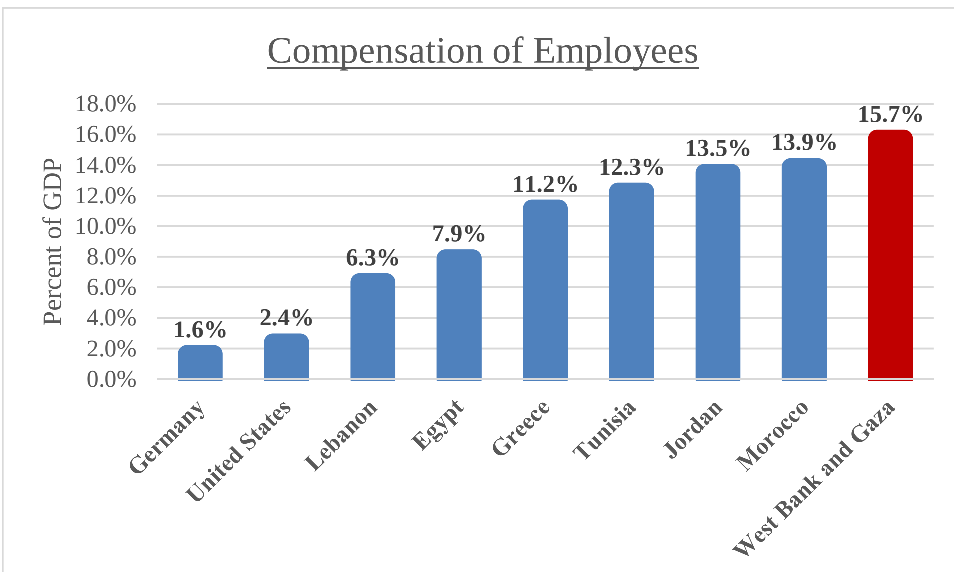
[31] For example, a prisoner serving 25-30 years is paid approximately $35,000 per year, and upon release receives a grant of $15,000 and an appointment to the rank of Major General in the security services. It is unclear how these payments to released prisoners are recorded or their total dollar amount. (Source: Israel Ministry of Foreign Affairs, "PA grants and salaries for Palestinian terrorists," June 25, 2014)

[32] Projected net acquisition of nonfinancial assets (i.e., development expenditures) have not been included as operating expenses. (Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 22)

E. Governmental Employee Compensation

25. The PA's projected wage bill for 2015 is expected to reach nearly $2.0 billion, equivalent to approximately 15% of the West Bank and Gaza's GDP. The PA's total wage bill as a percentage of GDP is high relative to international standards and high relative to regional standards. The PA Ministry of Finance attributes the disproportionate size of the total wage bill to overstaffing by the PA in the public education, health services, and security sectors.[33] The figure below presents the PA's wage expense relative to other countries.

Figure 1: 2012 Government Wages as Percentage of GDP[34]



[33] April 30, 2015 Declaration of Shukry Bishara, Exhibit A-11 (Ministry of Finance, "Fiscal Reforms, Entrenched Challenges and Future Objectives," Fiscal Sector Working Group, April 8, 2015), p. 25.
[34] See Exhibit 8

26. Multiple organizations have suggested that the PA engage in civil service reforms to reduce its wage bill.[35] The European Commission notes that countries at similar levels of development have total wage bills of approximately 10% of GDP.[36] To put this figure in perspective, reducing the wage bill to 10% of GDP would reduce PA employee compensation by about $650 million.[37]

27. The PA's wage bill increases have been driven by increases in employee headcount and consistent wage increases. The IMF notes that the PA's wage increases have consistently outpaced inflation.[38] For example, over the past five years (2009 through 2014), the PA's employee compensation increased by 37% while inflation increased by 14%.[39]

[35] According to a 2013 European Court of Auditors, the PA has made little progress on civil service or pension reforms: "After rapid expansion between 2000 and 2007, since 2008 the PA has tried to limit the growth in public sector employment to 3 000 employees per year. However, this level of growth still represents a significant additional burden on the overstretched budget. At the same time, the PA has made little progress on civil service and pension reforms to reduce the fiscal impact of the increasing numbers of staff and pensioners, for example, by reducing the number of PA staff or amending the rules regulating entitlements." (Source: European Court of Auditors, European Union Direct Financial Support to the Palestinian Authority, Special Report No. 14, 2013)

[36] European Commission, Evaluation of the European Union's Cooperation with the occupied Palestinian territory and support to the Palestinian people, Final Report, Volume 1, July 2014, p. xviii

[37] Reductions in the employee headcount would likely involve one-time severance payments.

[38] "Official donor aid peaked at 32 percent of GDP in 2006, when half of it went to development support. Since then, aid has declined to about 10 percent of GDP and development support has become severely squeezed. Over the same period, public recurrent expenditure increased in real terms by 9%, reflecting primary increases in wage spending that have persistently outpaced inflation and growth in net lending." (Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 30)

[39] See Exhibit 10. In 2014, the IMF estimated consumer price inflation to be 1.7% (Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 20). The PA Ministry of Finance provided the following breakdown for its 2014 wage increases of 6%: "This increase of 6% of the wage bill in 2014 over 2013 is broken down into: annual increase of 1.25%, inflation 2.03% and 0.5% paid on behalf of 3 months of 2013, cost of living allowance 0.86%, security sector promotions contributed 0.2%, agreement with teachers labor union increased the bill by 0.7%, and 0.4% represent court orders increases and risk allowances applied to various professions." (Source: PA Ministry of Finance, Fiscal Developments: Fourth Quarter and Full Year 2014, January 3, 2015)

Table 6: Historical Wage Bill Growth[40]

Annual Year-Over-Year Change (%)	2010 (Actual)	2011 (Actual)	2012 (Actual)	2013 (Actual)	2014 (Actual)	Average
Employee Count	1.8%	1.8%	0.8%	0.1%	0.9%	1.1%
Consumer Price Index	3.7%	2.9%	2.8%	1.7%	1.7%	2.6%
Wage Bill	12.2%	6.0%	6.8%	1.7%	5.9%	6.5%

28. The IMF projects that the PA's employee compensation expense will continue to outpace inflation through 2018. The IMF recommended that the PA limit wage growth to 2 percent per year. Current projections assume average growth in employee compensation of approximately 4 percent per year. I have estimated that growing employee compensation at an average rate of 2 percent per year (rather than the currently projected 4 percent per year) between 2016 and 2018 would result in total savings of $268 million (averaging $89 million per year).[41]

29. The IMF also recommended that the PA develop a contingency plan to accommodate significant deviations from its baseline projections.[42] According to the IMF, the broad range of remedial actions could include a "…freeze on wages, allowances, and promotions..." [43]

[40] See Exhibit 10
[41] See Exhibit 18
[42] The IMF recommended that the contingency plan be prepared, in part, to accommodate a large potential financial liability being assessed in this matter: "Fiscal risks are significant and largely relate to further interruptions in CR transfers, shortfalls in donor aid, and a potential large financial liability related to the Sokolow case. (Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 13)
[43] International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 10

30. I have estimated that maintaining employee compensation at 2015 levels of $2.0 billion per year for three years starting in 2016 would generate cumulative savings of approximately $500 million (averaging $168 million per year). This can be accomplished in at least four ways:

    a. Salary increases paid for by normal attrition through retirement, resignations, or death;
    b. A reduction of total headcount to fund salary increases;
    c. Salary decreases to fund new hiring; or
    d. Maintain existing total headcount and 2015 salary levels.

F. Spending on Public Order and Safety Salaries

31. The table below displays the Palestinian Authority's functional expenditures as a percent of total expenditures for 2014.

Table 7: Palestinian Authority Functional Expenditures (%)[44]

Expenditures (%)	Wages and Salaries	Transfer Expenditure	Use of Goods and Services	Development Expenditure	Social Contributions	Total Expenditure
Public Order and Safety	22.5%	-	2.4%	1.3%	2.2%	28.6%
Social Protection	1.5%	17.1%	-	-	-	19.1%
Education	14.4%	-	1.3%	1.0%	1.4%	18.4%
Health	4.9%	-	7.8%	-	-	13.4%
General Public Services	4.6%	2.4%	2.9%	2.0%	-	12.8%
Economic Affairs	1.6%	-	-	1.9%	-	4.1%
Recreation, Culture and Religion	1.7%	-	0.6%	-	-	2.6%
Housing and Community Amenities	0.5%	-	-	-	-	1.1%
Environmental Protection	-	-	-	-	-	-
Defense	-	-	-	-	-	-
Total:	51.8%	**20.0%**	**15.6%**	**6.9%**	**4.8%**	**100.0%**

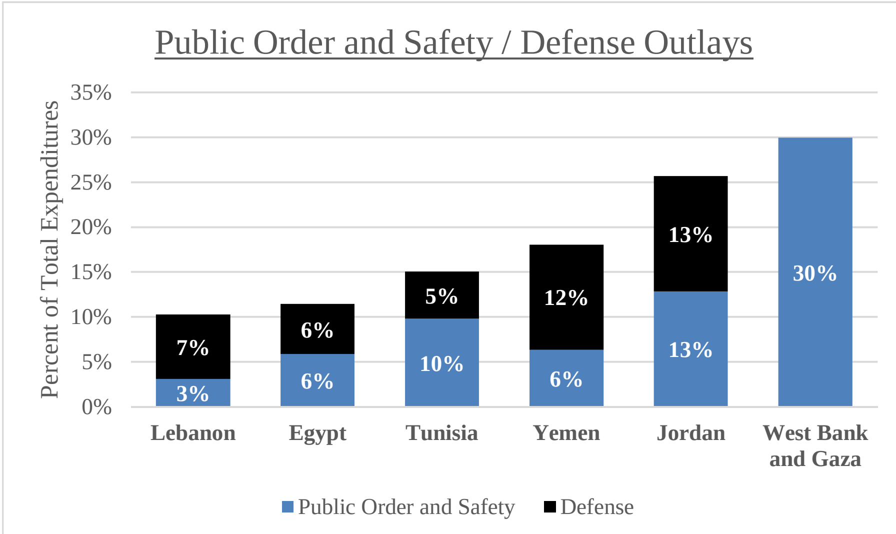
32. Public order and safety is the PA's largest expense, accounting for about 29% of operating expenses in 2014, with public order wages and salaries alone comprising 22.5% of all operating expenses in 2014.

33. I have used 2012 IMF data, the most recent data available, to evaluate the PA's spending relative to other countries. As shown in the table below, using 2012 IMF data, the PA's outlays on public order and safety (30% of expenses) were five times those of Egypt and more than two times those of Jordan in 2012. The PA's expenditures are even outsized

[44] Excludes interest payments and minor capital expenditures

when including these other countries' military expenditures, which would include military equipment and hardware not permitted to be purchased by the PA.[45]

Figure 2: 2012 Government Outlays as a Percent of Total Expenditures[46]



34. When including the DFG in Gaza's security/armed-forces personnel, the percentage of the West Bank and Gaza's workforce that is made up of security/armed-forces personnel (an estimated 7.3% of the workforce) is second highest in the world, behind the Democratic People's Republic of Korea ("North Korea").[47] As will be discussed below, the security personnel employed by the PA in Gaza (approximately 35,000 employees) are reportedly paid but not providing any public service.

[45]The UNDP notes that public order and security spending is at "8.7% of GDP is more than double the GDP shares in other countries. It exceeds spending on education and health combined. When this spending is combined with the defense category in other countries, it still exceeds their spending, except for Jordan. While security in Palestine is critical in maintaining political stability and the rule of law, spending on security is disproportionate relative to other countries. It becomes a structural and distributional issue for Palestinian public finance, to the extent that it adds to the fiscal deficit and crowds out other expenditures." (Source: United Nations Development Programme, Karim Nashashibi, "Palestinian Public Finance Under Crisis Management: Restoring Fiscal Sustainability", March 31, 2015, p. 46)

[46] The IMF does not classify the PA's spending on its security services as "defense" or "military" expenditures.

[47] See Exhibit 11

G. <u>West Bank Surplus and Gaza Deficits</u>

35. Documents prepared by the PA Ministry of Finance indicate that PA's deficits are principally driven by its activities in Gaza.[48] The PA's deficits related to Gaza are primarily attributable to:

    a. The PA has not received domestic tax and non-tax revenue from Gaza since Hamas came to power while continuing to provide wide-ranging governmental services.[49] In June 2007 the PA decided to exempt Gaza residents and companies from the income tax.[50]

    b. The PA maintains a governmental labor force in Gaza that is disproportionately large relative to the governmental services provided.

36. According to the Ministry of Finance's *2015 Fiscal Sector Working Group* presentation, *"Total balance of payment transfers to Gaza* ***are estimated at USD 1 billion per annum; thus 8 USD billion over 8 years."*** [51]

37. The PA has not collected tax revenue or electricity payments from Gaza since 2007, following Hamas's takeover of the Gaza strip and the establishment of the DFG. In effect, the population of the West Bank has been the source of nearly all of the PA's tax

[48] The PA Ministry of Finance reports that "[t]he West Bank on a stand alone [sic] basis records a surplus of NIS 3.26 billion" and that "[t]he Gaza Strip on a stand alone [sic] basis records a deficit of NIS 5.26 billion." (Source: April 30, 2015 Declaration of Shukry Bishara, Exhibit A-10)

[49] The IMF notes that "[d]omestic revenue from Gaza – tax and nontax – has not been received since 2006, when Hamas seized power in Gaza," yet continues to spend 40 percent of its wage bill on Gaza employees. (Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 38)

[50] United Nations Development Programme , Karim Nashashibi, "Palestinian Public Finance Under Crisis Management: Restoring Fiscal Sustainability", March 31, 2015, p. 15

[51] April 30, 2015 Declaration of Shukry Bishara, Exhibit A-11 (Ministry of Finance, "Fiscal Reforms, Entrenched Challenges and Future Objectives," Fiscal Sector Working Group, April 8, 2015), p. 25.

revenue.[52] The World Bank has estimated that Gaza has the potential to generate $550 million per year, or more, in additional tax and electricity payment.[53]

38. The PA Ministry of Finance reported that the salaries for the PA employees deployed in Gaza were equal to $824 million in 2014.[54] According to the UN, the PA had approximately 26,000 permanent civilian employees and 35,000 security personnel in Gaza during September 2014.[55]

39. The PA's 61,000 employees deployed in Gaza are in addition to the DFG's 36,000 employees, comprised of 20,000 permanent civilian employees and 16,000 security personnel.[56] It has been estimated that if the PA and DFG's two parallel sets of civil employees were combined, Gaza would have a redundancy of at least 23,000 civilian personnel and 20,000 security personnel.

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[52] The PA Ministry of Finance notes that "[a] decree was passed in June 2007, exempting the income-generated out of Gaza from all taxes (VAT and income tax)…This is tantamount to a tax exemption for 40% of the Palestinian population." (Source: April 30, 2015 Declaration of Shukry Bishara, Exhibit A-11, (Ministry of Finance, "Fiscal Reforms, Entrenched Challenges and Future Objectives," Fiscal Sector Working Group, April 8, 2015), p. 24)

[53] Made up of $350-$400 of potential domestic taxes and import duties and $200 million in collections for electricity payments currently covered by the PA (Sources: World Bank, Supplemental Financing Document For A Proposed Gaza Emergency Response Supplemental Financing in the Amount of US$41 Million to the Palestine Liberation Organization, p. 10; World Bank, Economic Monitoring Report to the Ad Hoc Liaisons Committee, May 27, 2015, p. 9)

[54] Source: April 30, 2015 Declaration of Shukry Bishara, Exhibit A-10. p .38. Wage expenses for Gaza are reported as 2940 MM NIS and converted at an exchange rate of 3.57 NIS/USD, per the Palestinian Authority Ministry of Finance December 2014 Monthly Report, to arrive at $824 million (2,940/3.57 =$823.53)

[55] United Nations Development Programme , Karim Nashashibi, "Palestinian Public Finance Under Crisis Management: Restoring Fiscal Sustainability", March 31, 2015, p. 50

[56] United Nations Development Programme , Karim Nashashibi, "Palestinian Public Finance Under Crisis Management: Restoring Fiscal Sustainability", March 31, 2015, p. 50

40. Multiple public sources indicate that the majority of the PA's employees in Gaza provide little, if any, public service.[57] It has been reported that the PA has made little effort to reduce its spending on these public servants.[58] In fact, the European Court of Auditors has recommended that aid monies "for civil servants in Gaza to be discontinued and redirected to the West Bank."[59] I have estimated the annual cash expense for PA employees in Gaza that are not working to be approximately $560 million per year.[60]

H. <u>International Monetary Fund Revenue Enhancement Recommendations</u>

41. As noted above, the IMF highlighted the fact that "government revenue in the [West Bank and Gaza] is lower compared to most of the countries in the [Middle East North Africa] region, and it is significantly lower than the average for the [West Bank and Gaza's] peer countries in the lower-middle-income group."[61] The IMF stated that "[s]ignificant potential exist[s] for raising domestic tax revenue in the [West Bank and Gaza]," specifically eliminating taxation exemptions, increasing registered tax payers, improving tax compliance, phasing out tax incentives, and reintroducing of tax collection

[57] It has been reported that after the DFG came to power, the PA's security personnel and a large segment of the civil service became unemployed (Source: United Nations Development Programme, Karim Nashashibi, "Palestinian Public Finance Under Crisis Management: Restoring Fiscal Sustainability," March 31, 2015, p. 48). Public documents suggest that 30% of the PA's civilian staff is currently not working (Source: European Commission, Evaluation of the European Union's Cooperation with the occupied Palestinian territory and support to the Palestinian people, Final Report, Volume 1, July 2014, p. 78).

[58] For example, the UNDP noted: "[Gaza] employees were all paid full salaries although many of them took up part time jobs. Given the financial difficulties experienced by the PNA it is surprising that no efforts were made to secure some savings in the Gaza wage bill. One obvious approach would have been to pay lower salaries. The only measures taken by the PNA in 2013 were a postponement of the cost of living allowance (also applied to the West Bank) and elimination of supervisory allowances." (Source: United Nations Development Programme, Karim Nashashibi, "Palestinian Public Finance Under Crisis Management: Restoring Fiscal Sustainability," March 31, 2015, p. 48)

[59] European Court of Auditors, European Union Direct Financial Support to the Palestinian Authority, Special Report No 14, 2013, p. 35

[60] See Exhibit 15

[61] International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 35

in Gaza.[62] The IMF estimates that the PA could increase revenues by as much as 10 percent of GDP through a series of gradual reforms.[63] Although the IMF noted that these targets were unlikely to be realized in the short term, it suggested that these revenue enhancements can be achieved gradually.[64] If the PA were to implement the IMF's recommendations over a decade at a rate of 1% of GDP per year, the following cumulative revenue increase would total $900 million by 2018 (and $2.5 billion by 2020):

Table 8: Cumulative Effect of Increasing Revenue 1% Per Year[65]

Effect of 1% Revenue Increase / Year	2016 (Proj.)	2017 (Proj.)	2018 (Proj.)	2019 (Proj.)	2020 (Proj.)
Nominal GDP (USD, millions)	$13,881	$14,731	$15,656	$16,649	$17,708
Annual Effect	$139	$295	$470	$666	$885
Cumulative Effect for PA	**$139**	**$433**	**$903**	**$1,569**	**$2,454**

[62] International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 36
[63] See Exhibit 13
[64] A PA Ministry of Finance document details the PA's initial plans to increase revenues through the expansion of the tax base and the amendment of the 1998 Investment Promotion Law, among other initiatives. (Source: April 30, 2015 Declaration of Shukry Bishara, Exhibit A-11, (Ministry of Finance, "Fiscal Reforms, Entrenched Challenges and Future Objectives," Fiscal Sector Working Group, April 8, 2015))
[65] West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p 20.

I. PA Ministry of Finance Fiscal Initiatives

42. The PA Ministry of Finance published several documents in 2015 that reviewed and quantified the effects of certain budgetary items and developed recommendations that are generally consistent with the findings of the IMF, World Bank, and United Nations:

a. **Fuel Subsidy**– Complete 100% phase-out of the fuel subsidy.[66]

b. **Utilities Payment –** Increase the collection rate for electric utilities.[67] Reduce electricity non-payment and pilferage by introducing pre-paid meters and enacting punitive administrative decrees.

c. **Reform to the Wage Bill –** Rationalizing compensation benefits and capping wage bill increases. During the past 5 years, the PA's total employee compensation expense has outpaced inflation by about 4%.

d. **Investment Promotion Law Phase-out –** Complete the *zero-rate tax holiday* scheduled phase-out.

e. **Referral to Israeli Hospitals –** Reduce the cost and number of referrals to Israeli hospitals, which is "next to net lending a major drain on the financial resources of the PA."[68]

[66] See the April 30, 2015 Declaration of Shukry Bishara, Exhibit A-11 (Ministry of Finance, "Fiscal Reforms, Entrenched Challenges and Future Objectives," Fiscal Sector Working Group, April 8, 2015), p. 26. The IMF states that the PA is "committed to contain subsidies at about NIS 25 million per month." (Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 9

[67] For example, the PA notes that it pays approximately $150 million per year (NIS 45 per month, translated at a rate of 3.57 NIS/USD) for electricity from Gaza but receives no collection revenues (Source: Exhibit A-10 to the April 30, 2015 Declaration of Shukry Bishara ("Palestinian Government's Reforms - Work in Progress – Challenges and Risks"), p. 28)

[68] Source: Exhibit A-10 to the April 30, 2015 Declaration of Shukry Bishara ("Palestinian Government's Reforms - Work in Progress – Challenges and Risks"), p. 31

f. **Increase Taxpayer Compliance –** Increase the number of taxpayers by 12,000.[69] The PA has a pervasive history of tax avoidance and non-compliance. In 2014, there were 167,000 registered tax payers in a population of over 4 million people.

J. Resolving Commercial Issues with Israel

43. The PA Ministry of Finance notes there are a number of unresolved commercial issues with Israel that, once resolved, will generate approximately $230 million per year for the PA. The open commercial issues include VAT revenues not captured by the PA, custom taxes on indirect imports, health insurance and taxes on Palestinian workers in Israel, property taxes and fees, telecom taxes, border transit fees and other Area C taxes.[70]

[69] The PA states that domestic tax revenues were provided by less than 30 percent of the potential tax base. (Source: Exhibit A-10 to the April 30, 2015 Declaration of Shukry Bishara ("Palestinian Government's Reforms - Work in Progress – Challenges and Risks"), p. 5). According to the UN, 80% of potential taxpayers in the West bank and Gaza do not pay income tax and only 66% of registered individuals are filing returns. (Source: United Nations Development Programme, Karim Nashashibi, "Palestinian Public Finance Under Crisis Management: Restoring Fiscal Sustainability", March 31, 2015, p. 41)

[70] Estimated by the PA to be $230 million annually, once resolved (Exhibit A-10 to the April 30, 2015 Declaration of Shukry Bishara)

K. IMF-Recommended Contingency Plan

44. The IMF also recommended that the PA prepare a fiscal contingency plan to accommodate deviations from its financial projections.[71] The IMF suggested the following items for increasing operating income: [72]

    a. Freeze on wages, allowances and promotions;

    b. Rationalization of transfers;

    c. Immediate withdrawal of fuel subsidies;

    d. Further reduction in tax incentives;

    e. Increase in government fees;

    f. Increase in dividends from the Palestinian Investment Fund.

45. My analysis indicates that implementing even a portion of these fiscal initiatives would allow the PA to generate significant funds to secure and ultimately satisfy the awarded damages. For example, a June 2014 IMF report estimated that the elimination of the fuel tax subsidy and rationalization of transfers could save $124 million and $97 million,

[71] The IMF recommended that the contingency plan be prepared, in part, to accommodate a large potential financial liability being assessed in this matter: "Fiscal risks are significant and largely relate to further interruptions in CR transfers, shortfalls in donor aid, and a potential large financial liability related to the Sokolow case." (Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 13)

[72] International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 10

respectively.[73] Additionally, I have estimated that freezing employee compensation could generate total savings of over $500 million between 2016 and 2018.[74]

L. Emergency Cash Rationing Budget

46. In January 2015, in response to the Israeli freeze on transfer revenues, the Palestinian Authority implemented an "emergency cash rationing budget" and made the following governmental operations funding cuts:[75]

    a. **65%** reduction in wages and salaries for Palestinian Authority employees;

    b. **19%** reduction of transfers of social assistance benefits, social security, and related government assistance programs;

    c. Withheld **42%** of payments to private sector for good and services; and

    d. Withheld **14%** of interest payment due on existing Palestinian Authority debt.

47. The funding cuts in the PA's emergency cash rationing budget were larger in magnitude and significantly more severe than the contingency plan suggested by the IMF.

[73] Source: International Monetary Fund, "West Bank and Gaza – Report on Macroeconomic Developments and Outlook", June 30, 2014, p. 9)
[74] See Exhibit 17
[75] Palestinian Authority Post-trial Motion, April 30, 2015, p. 1-12.

M. Cumulative Deficits

48. The PA's current level of public debt and arrears is sustainable in the medium term and can be gradually amortized over the next decade.[76] The PA at year-end 2014 had approximately $2.2 billion in total government debt, equivalent to approximately 17% of GDP.[77] By comparison the debt-to-GDP ratios for many countries are higher: Tunisia (44.5%), Jordan (66.8%), Morocco (59.7%), Germany (55.2%), and the United States (94.3%).[78] The PA also had approximately $2.5 billion in arrears (to pension fund and accounts payable to private-sector creditors).[79]

49. On average $200 million per year should be allocated to amortization of private sector arrears (accounts payable) existing bank debt, and the PA's interim operating deficits.

50. Governments and U.S. municipalities routinely carry large unfunded pension liabilities. The PA's pension fund arrears are long-term in nature and do not need to be immediately fully funded. In the near term, I recommend that the continuation of the PA's pay-as-you-go policy, pending the implementation of its tax and fiscal reforms.

51. In my opinion, PA's cumulative deficit is best viewed as a capital item, which should be amortized over time.

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[76] In its more recent report, IMF states that "public debt in the baseline scenario is sustainable in the medium term…" (Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 27)
[77] Source: Palestinian Monetary Authority
[78] Data as of 2012 (Source: World Bank, World Development Indicators, Table 4.12)
[79] Approximately 70% of the PA's arrears in 2014 represented pension fund liabilities. The IMF notes that the PA's reported public sector arrears "are overestimated to the extent that the available information does not allow to distinguish between payments due and payments past due." (Source: International Monetary Fund, "West Bank and Gaza – Report to the Ad Hoc Liaison Committee", May 18, 2015, p. 26)

V. CONCLUSION

52. In my opinion, the PA has the ability to pay Plaintiffs' awarded damages of $655.5 million dollars from operating income at a scheduled payment rate of not less than $20 million per month for the first 18 months and not less than $25 million per month thereafter.

53. My conclusions are based on the following fiscal initiatives and financial opportunities, which were identified by the IMF, the World Bank, the United Nations, and the PA Ministry of Finance itself:

    a. The PA operating budget is projected to be balanced by 2018.

    b. Maintaining total employee compensation at 2015 levels, would generate cumulative savings of $500 million over three years.

    c. The PA wage bill includes $560 million of annual compensation to Gaza employees that do not provide any governmental services.

    d. Reinstitution of tax collection and electricity billing in Gaza could generate $550 million per year, or more.

    e. Improving the PA's West Bank tax collection and enforcement would generate $315 million per year, or more.

    f. Once fully implemented, resolving outstanding commercial issues with Israel that were identified by the PA Ministry of Finance would produce a financial contribution of $230 million per year.

g. The existing debt and interim operating deficits are manageable, not requiring expenditures of more than $200 million annually.

54. The annual incremental operating income from full implementation of these fiscal initiatives would exceed $1.2 billion.[80] After adjusting for deficit, debt and arrears amortization, approximately $1 billion per year would be available for satisfying this Court's judgment.

Bradley W. Wendt
July 13, 2015

[80] See Exhibit 1